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### ***Governance and inequality: Benchmarking and interpreting South Africa's evolving political settlement***

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## **Abstract**

Has South Africa's political settlement provided a constructive platform for successfully addressing the country's deep-seated economic challenges in an inclusive way? Or is it increasingly consolidating as a settlement which is narrowly of and for elites (albeit in importantly different ways from its apartheid predecessor)? This paper addresses these questions, and reexamines the foundations of the democracy in an attempt to understand the obstacles to South Africa moving into a truly sustainable democracy. It provides a broad overview of South Africa's evolving political settlement and the capability and commitment of the South African state (and the elites which underpin it) to deliver inclusive development. The political settlement analysis is anchored in a comparative assessment of evolving patterns of income distribution across countries and over time. The paper offers reflections on how the challenges going forward for South Africa might be addressed.

**Keywords:** South Africa, inequality, political settlement, inclusion, democracy, elite bargain

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## **Introduction**

In a dramatic few years, South Africa shifted from being trapped in an apparently intractable conflict between a dominant white minority and an oppressed black majority to being a democratic state with an outstanding progressive liberal constitution. It moved from being the epitome of racial conflict to a model of peaceful transition. And yet, 20 years later, the cracks in the settlement are all too clear and the risks of internal conflict are growing. The transition is truncated.

Why is it so hard to progress beyond an apparently brilliant political settlement into an inclusive society? We believe that the foundations of the democracy need to be reexamined in order to help us understand the obstacles to South Africa moving into a truly sustainable democracy. So, this paper will provide a broad overview of South Africa's evolving political settlement and the capability and commitment of the South African state (and the elites which underpin it) to deliver inclusive development. The paper has five sections.

From the perspective of the 'political settlements' literature, Sections 1 and 2 are conventional. Section 1 situates South Africa's political settlement within the comparative typology which is being used as an analytical platform for the Effective States and Inclusive Development (ESID) research programme as a whole. Section 2 provides an overview of the political 'miracle' of South Africa's transition to democracy, and how it was achieved. (This story is both well known, and has been thoroughly documented elsewhere; this part of the paper will take the form of a summary review of the key literature.)

Going beyond the conventional discourse, Sections 3-5 seek to anchor the analysis of South Africa's political settlement in a comparative assessment of South Africa's evolving patterns of income distribution across countries and over time. (The South African literature includes careful analysis of changing patterns of distribution and their relation to politics en route to the 1994 democratic transition [see especially Seekings and Nattrass, 2005], but comparative assessment of similarities and differences to other middle-income countries remains underdeveloped.) Section 3 contrasts the South African patterns with those of other middle-income countries. Section 4 explores how the South African distribution has evolved post-apartheid, disaggregating between (and within each of) the poorest 40 percent of the population, the uppermost 20 percent, and the 'middle' 40 percent. Section 5 builds on the empirical analysis to reflect more broadly on the stresses and strains in South Africa's evolving political settlement, and how the challenges going forward might be addressed.

### **1. Characterising South Africa's political settlement – a comparative typology**

The analytic framework laid out in Levy (2014) is being used across the ESID countries as a basis for distinguishing among different types of political settlements – and, as such, provides a useful point of departure for an analysis of South Africa's evolving political settlement. Levy distinguishes among countries according to three sets of variables:

- whether the political arrangements are dominant or competitive;
- whether institutions are personalised or impersonal; and
- the extent of economic inclusion.

**Figure 1: A development typology**

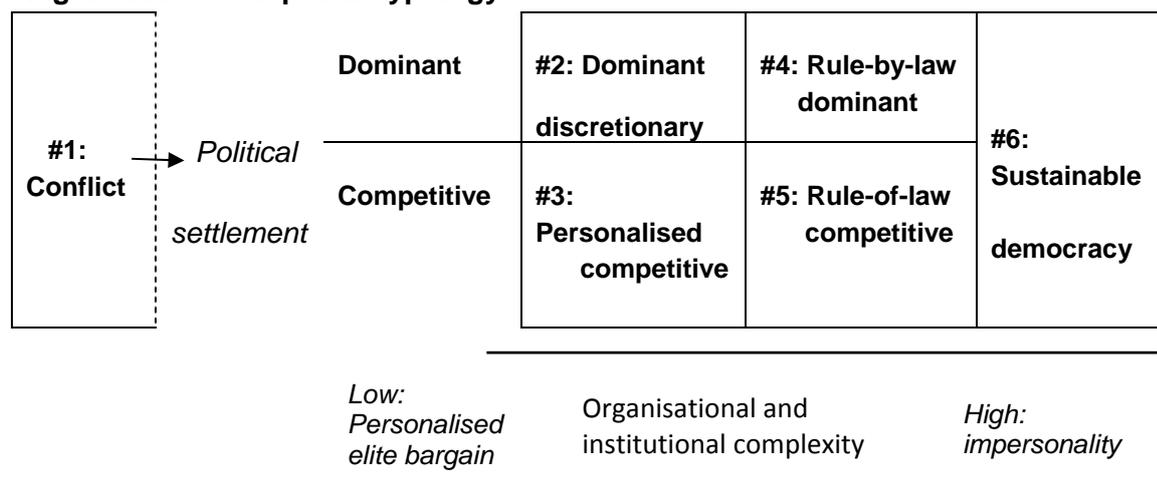


Figure 1 uses these variables to distinguish among six groups of countries:

- *Conflict (cell #1)*, where endemic, violent conflict repeatedly undercuts the potential for development to take root.
- *Dominant discretionary (cell #2)*, where strong political leadership (perhaps military, perhaps civilian; perhaps organised around a political party, perhaps a charismatic individual) has successfully consolidated its grip on power, but formal institutions remain weak, so rule is personalised.
- *Rule-by-law dominant (cell#4)*, where institutions are more impersonal, but political control remains monopolised.
- *Personalised-competitive (cell #3)*, where politics is competitive, but the rules of the game governing both the polity and the economy remain personalised.
- *Rule-of-law competitive (cell #5)*, where the political and economic rules have become more impersonal – though some other necessary aspects of democratic sustainability have not yet been achieved. Of special relevance in the South African context (and central to the analysis of this paper) are shortfalls of economic inclusion of sufficient severity to threaten the broader legitimacy and sustainability of the institutional order.
- *Sustainable democracy (cell #6)*, where political contestation plays out in the context of broad social consensus as to the legitimacy of the underlying political, social and economic order.

For the purposes of the present paper, the distinction between cells #5 and #6 is crucial: both are characterised by an impersonal and competitive political order; but only in cell #6 is democracy sustainable. This will be discussed in more detail below.

As a first step in characterising South Africa's political settlement along the dimensions highlighted in Figure 1, Table 1 uses the globally recognised Polity IV data set. The patterns which emerge are straightforward:

- The 'executive constraints' variable measures the extent to which checks and balances constrain the discretionary authority of the executive.<sup>1</sup> Going back at least to 1910 (the year in which four former Boer republics and British colonies were constituted into a 'Union of South Africa'), Polity IV gives South Africa the maximum possible score of '7' – signalling that, at least in relation to the minority settler community (though, of course, not the country's black majority population), the rule of law consistently was strong in relative terms.
- Polity IV's (adjusted) 'democracy measure'<sup>2</sup> similarly gives South Africa an 'intermediate' score of 4 points for most of the 20th century (reflecting the reality of a democratic electoral process within the white minority population) – with the score rising to 6 (of a possible seven points) in response to the country's negotiated move to democracy in 1994.

Each of the above warrants further comment.

Consider first the South African score for 'executive constraints'. Viewed from a contemporary human rights perspective, Polity IV's scoring prior to 1990 gives far too much emphasis to the constitutional protections enjoyed by the white minority, relative to the unconstrained, violent use of power by the state against the country's black majority population. But the basic point remains. In global comparative terms – and within the country's white minority population – South Africa has long had a relatively strong rule of law.

**Table 1: South Africa's political settlement – Polity IV scores**

	1989	2005	2012
<b>Democracy (adjusted)</b>	4	6	6
<b>Executive constraints</b>	7	7	7

Source: Polity IV data set

<sup>1</sup> 'Executive constraints' as defined in the Polity IV data set refers to the extent of institutionalised constraints on the decision-making powers of political chief executives, whether individuals or collectivities. Such limitations may be imposed by any 'accountability groups'. The concern is therefore with the checks and balances between the various parts of the decision-making process. See Marshall, Gurr and Jagers (2013). Both Marshall, Gurr and Jagers (2013) and the Polity IV data, are available at <http://systemicpeace.org/polity/polity4.htm>.

<sup>2</sup> Polity IV includes a composite measure of 'democracy', which rates countries on a 0-10 scale, based on four sub-indicators: (i) *the competitiveness of political participation* – the extent to which alternative preferences for policy and leadership can be pursued in the political arena; (ii) *the competitiveness of executive recruitment* -- the extent to which prevailing modes of advancement give subordinates equal opportunities to become superordinates; (iii) *the openness of executive recruitment* – the extent to which all the politically active population has, in principle, an opportunity to attain the chief executive position through a regularised process; and (iv) *executive constraints*. The 'executive constraints' sub-indicator cuts across the analytical distinction in the typology between the vertical (dominant-competitive) and horizontal (personalised-impersonal) axes. Weighting 'executive constraints' as heavily as Polity IV does for its democracy variable would confound the distinction between the two dimensions, but excluding it entirely would lose an important differentiator for the vertical axis. So it is used, but given less weight.

Now consider the score for the 'democracy' variable. South Africa's formal constitution is often hailed as a model globally – and the de facto implementation of the rules governing the democratic process has been exemplary. In practice, a single party (the African National Congress) has dominated national elections since 1994. Its share of votes consistently has been in excess of 60 percent; in 2004, its vote share exceeded the two-thirds majority needed to amend the constitution. Even so, elections receive sustained public attention, and can be highly contested. In 2009, the ANC lost control of the second most powerful province economically, the Western Cape; in 2014, its share of the vote in the economic powerhouse of Gauteng fell below 54 percent. We believe that a score of 6 of a possible seven points is thus an accurate characterisation of the state of South Africa's democracy. (There is further discussion later in the paper on the broader political implications of limited political competition.)

The third set of variables highlighted by Levy (2014) – the extent of economic inclusion – is a major pre-occupation of this paper. Table 2 reports on Gini coefficient measures of inequality for eight countries across a range of per capita incomes. (More on these countries below.) As the table suggests, South Africa is among the most unequal middle-income countries globally.

**Table 2: Gini Coefficients of inequality for eight countries, 2006**

South Africa	0.67	Brazil	0.57
Zambia	0.55	Mexico	0.48
Kenya	0.48	United States (1996)	0.46
Thailand	0.42	Turkey	0.40

Source: World Bank, Development Research Group, accessed at <http://data.worldbank.org/indicator/SI.POV.GINI/countries>. Estimates are based on primary household data. US estimate is from Milanovic, as detailed further below.

The relationship between inequality and democratic sustainability is a complex one.<sup>3</sup> Using formal modelling, Acemoglu and Robinson (2005)<sup>4</sup> conclude that 'a strengthening of the middle class in terms of an increase in either its size, political power, or relative income, may lead to the consolidation of a previously unconsolidated democracy.' South Africa not only has an unusually high Gini coefficient, but, as we shall see in later sections, its middle class is disproportionately weak. Levy distinguishes between two transitions from rule-by-law dominance to political competitiveness. As he notes:

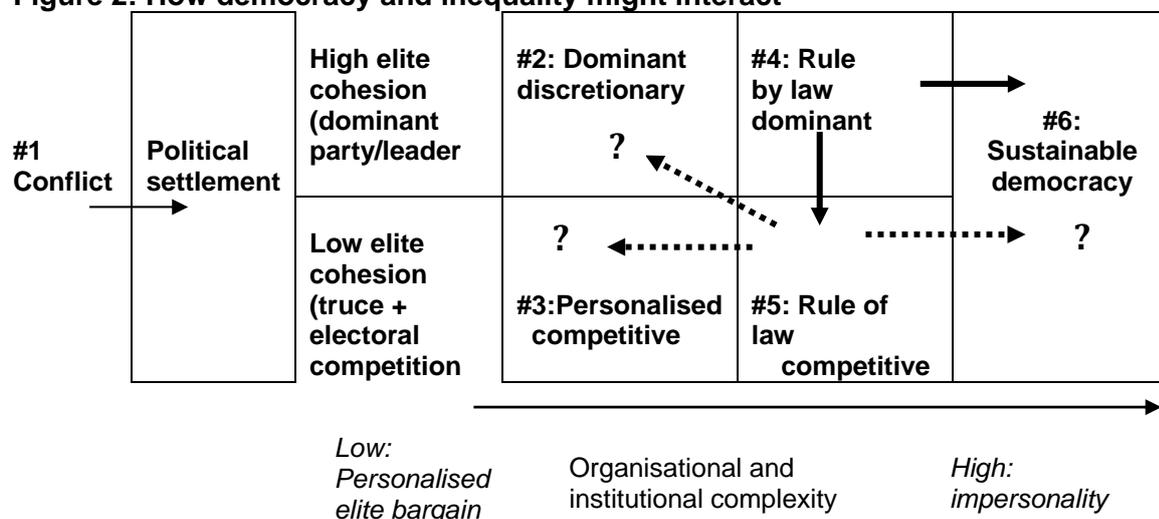
"Some countries may indeed be able to make a leap from rule-by-law dominance (cell #4 in Figure 2) to sustainable democracy (cell #6); but where inclusion has not yet been adequately consolidated, a move to democracy takes a country from cell #4 to cell #5, rather than cell #6. As the dotted arrows in Figure 2 imply, whether a country moves forward from cell #5 toward sustainable democracy, or backward toward more personalized

<sup>3</sup> For a comprehensive review, see World Bank (2006), especially pp. 101-144.

<sup>4</sup> The quote is from the concluding section of Chapter 8, 'The role of the middle class'.

institutions is likely to depend importantly on how effectively the challenge of inclusion is addressed.” (Levy, 2014: 99-100)

**Figure 2: How democracy and inequality might interact**



Two decades into democracy, in which direction is South Africa's 'rule of law competitive' institutional order evolving? Table 3 uses the Worldwide Governance Indicators (WGI) to summarise trends for two dimensions of South African governance: government effectiveness and control of corruption. According to the WGI data, between 1996 and 2012, the quality of governance declined across both dimensions, both absolutely (using the WGI -2.5 to + 2.5 scale) and relatively (measured by percentile rank in relation to a total of 215 countries). For all of the well known difficulties in measuring governance, the estimated standard errors for each measure (also reported in Table 3) strongly suggest (especially for control of corruption) that there is more to the decline than year-on-year measurement error.<sup>5</sup>

**Table 3: Trends in South African governance over time**

	Government effectiveness			Control of corruption		
	Point estimate	Standard error	Percentile rank	Point estimate	Standard error	Percentile rank
1996	0.88	0.23	79	0.76	0.23	79
2002	0.64	0.17	74	0.39	0.16	69
2012	0.33	0.18	64	-0.16	0.14	53

Source: Worldwide Governance Indicators.

To better understand the reason for these trends, this paper focuses on the impact on governance of South Africa's exceptionally (and continuing) high levels of inequality reported in Table 2 – with an emphasis on micro-level dynamics associated with specific

<sup>5</sup> As a very, very rough rule of thumb, differences between two point estimates that are less than the sum of the standard errors for each estimate are unlikely to meet the test of being statistically different from zero with 90 percent probability. For details of the Worldwide Governance Indicators and their construction, see Kaufmann, Kraay and Mastruzzi (2010). For a critical assessment of the WGIs, see Thomas (2009).

distributional sub-groups. Hypotheses as to how inequality, considered from this micro-level, might causally influence governance include the following:

- Continued disproportionate influence among established economic elites (including via non-transparent political party financing) – resulting in the perpetuation of exclusionary economic policies biased towards minerals, energy and capital-intensive segments of the economy.
- An all-or-nothing struggle among politically-connected actors to use their political influence to become part of the small (but very affluent) economically privileged elite segment of society, manifested in:
  - Contestation over senior public sector jobs, with participation in patronage networks often at least as important as skills and qualification;
  - Contestation (also organised around patronage networks) for nomination to politically influential and well-paid elected positions at national, provincial and local levels; and
  - Personalised control over procurement contracts – and associated side payments;
- The consolidation of an ‘insider’ group of formal sector employees – both white collar jobs (especially within an expanding public sector), and the subset of formal blue collar positions in industry and mining capable of supporting high wage employment – and the associated skewing of decision-making in their favour, to the neglect of both the quality of public service provision and of job creation at lower earnings levels.
- The deepening of patronage networks which link the provision of public services to favoured ‘clients’ and political support, especially within low-income (rural and urban) segments of society.

A final, overarching hypothesis is that the cumulative consequence of the above could be a growing sense of the unfairness of the system, a loss of hope among the majority in the prospects of a better future – and associated declines in the perceived legitimacy of the prevailing ‘rule of law competitive’ governance order, and thus of civic support for its defence in the face of creeping erosion of rule-boundedness.

## **2. How South Africa’s political ‘miracle’ was achieved – an overview**

Apartheid was built on a colonial system which privileged white settlers and controlled the labour market for indigenous peoples. This was facilitated by the way that cheap black labour was exploited in mines owned by large internationally funded mining companies and by white Afrikaner-owned farms. Black people were confined to labouring roles. As Hendrik Verwoerd, soon to become prime minister, put it: “There is no place for him [black men] in European [white] society above the level of certain forms of labour” (Welsh, 2009: 64). Poor whites, in contrast, were elevated out of poverty through education, state employment and racially restrictive employment laws (see Lipton, 1986: ch.7). Nelson Mandela in 1955 described the economic impact of apartheid as “the creation of a vast market of cheap labour for mine magnates and farmers” (Johns and Hunt Davis Jr., 1991: 47).

The combination of racial and economic division and oppression led to the emergence of a powerful African nationalist opposition movement which worked with other 'non-European' protest movements, left-wingers and trade unionists to fight against apartheid. After violent oppression by the state provoked the African nationalists in the early 1960s to commit to armed struggle, the leading nationalist movements were banned. By the 1980s, the opposition movement consisted of the banned African National Congress waging a largely symbolic armed struggle from exile, but working in consonance with the broad internal opposition under the civic bodies in the United Democratic Front and the black trade unions largely in the Congress of South African Trade Unions, COSATU (Seekings, 2000; Welsh, 2009: ch.8).

## **2.1. From conflict to agreement**

Already by the mid-1950s, the cheap labour system was reaching its limits as an engine of growth. But with the National Party coming into power in 1948, apartheid became entrenched as a political system and failed to adjust to the need for the economy to produce a broader educated and trained workforce and a growing domestic market. The sharp rise of the price of gold in 1970, still 70 percent of South Africa's exports, disguised the growing crisis of sustainable growth, but the collapse of the price of gold in the 1980s removed the fig leaf and exposed a shrivelling South African economy (Gelb, 1991: ch.1).

While government resisted real reform, leaders in business successfully sought contact with the African National Congress in exile. A meeting in Zambia led by the CEO of the giant South African conglomerate, Anglo American, sparked off a series of meetings between business and the ANC, followed by other forward thinkers from the white elite. Senior members of government met Mandela around the same time but failed to find a common way forward.

In the late 1980s, the ANC in exile sent signals that potentially were supportive of negotiation. In contrast with a more conventionally radical, anti-colonial, socialist position in the early 1980s, the constitutional guidelines published by the ANC in 1988 referred to a mixed economy "with a public sector, a private sector, a cooperative sector and a small-scale family sector" (ANC, c.1989: 12) The 1989 Harare Declaration issued by the Organisation of African Unity, but authored by the ANC, guaranteed a liberal pluralistic democracy with an implicit separation of powers, and included in a draft bill of rights clauses such as: "All shall enjoy universally recognised human rights, freedoms and civil liberties, protected under an entrenched Bill of Rights."<sup>6</sup>

White elites were driven to consider negotiations by the rapidly weakening economy, and the ANC knew that the military might of apartheid would make the struggle for democracy lengthy and very bloody. Nevertheless, without visionary and bold leadership displayed on both sides, there was no inevitability of resolution. The South African negotiations between 1990 and 1994 coincided with costly, bloody conflicts in Northern Ireland, Rwanda and former Yugoslavia. In this context, the quality of South African leadership was clearly evident.

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<sup>6</sup> Available online: <http://www.anc.org.za/show.php?id=3856>.

The elections of April 1994 occurred under an agreed interim constitution. The final constitution, agreed two years later, embodies, in part, the outcome of the agreement.<sup>7</sup> On the one hand, the constitution includes aspirational third-generation socio-economic rights, ahead of most contemporary constitutions. On the other hand, it gives strong support and guarantees to property rights, not so much that the inequities of the apartheid era could not be challenged, but enough to subject potential land redistribution to open and transparent legal processes. The constitution's strong checks and balances arrangements were designed to provide assurance to political minorities and owners of economic assets (drawn disproportionately from those minorities) that their rights would be protected, notwithstanding the strong likelihood that, for some elections to come, the ANC would command a strong majority of the vote, and be the ruling party. In all and on balance, owners of assets were indeed reassured.

Notions of radical reform which had dominated the discourse of the ANC alliance until the late 1980s were put on the back burner in the constitutional talks and in the policies of the new ANC government after 1994. This was a pragmatic response to circumstances that prevailed: the white owners of assets also virtually monopolised professional and managerial skill sets. In addition, foreign investors were seen to have huge potential power to shift funds, and were thought to view the new government with scepticism at the very least.

## **2.2. South Africa's political settlement – an initial summary**

Though, as we shall see, much has evolved in the decades subsequent to 1994, two central features of South Africa's political settlement were clearly evident even at the outset. First, the settlement comprised a negotiated agreement between an economically and militarily dominant white minority elite and a liberation movement acting on behalf of a historically oppressed majority. The agreement was a compromise between these powerful, opposing forces. The country's constitution constrained the freedom of manoeuvre of government in a way which largely protected the economic and other privileges of the pre-existing elite. In return, majority rule would prevail – and, with it, control over fiscal resources. Further, the white business elite signalled (via actions pre-dating the 1994 elections) its willingness to be pro-active in progressively sharing ownership of assets and managerial control with individuals from the black majority – although the details remained to be worked out.

Second, as with many national liberation movements, the ANC was a 'big tent'. Formally, it was an 'alliance'; its alliance partners comprised organised black workers (via COSATU) and the South African Communist Party. In practice, its voting support was drawn from across the spectrum of black South African society – from (the relatively small) black professional and business class, to urban employed workers, many migrant workers, rural peasants and landless people – and many desperately poor people living on the fringes of urban society, including many located in desolate places, far from vibrant economic activity, where they had been dumped as part of apartheid's social engineering follies. The ANC's support base was also very diverse geographically and ethnically – with the party winning a decisive electoral

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<sup>7</sup> For a sampling of the many detailed descriptions and analyses of South Africa's political settlement and how it was achieved, see Atkinson and Friedman (1994); van Zyl Slabbert (1992); Marais (2001).

majority in most, but not all,<sup>8</sup> provinces. These disparate groupings had divergent economic and political interests – so the likelihood was strong that policy would be pulled in multiple, sometimes mutually inconsistent, directions.

### **3. South African income and inequality across countries and over time**

#### **– an overview**

South Africa may have achieved a political miracle in 1994, but the triple economic legacies of poverty, inequality and joblessness have proven stubbornly difficult to change. Yet there is a frustrating lack of clarity to the discourse:

- *On poverty:* At the beginning of the second decade of the 21st century, there continues to be deep and pervasive poverty in the country. But how does the pattern compare with that of other countries? Is it more or less desperate? More or less pervasive?
- *On inequality:* Certainly, contemporary disparities are vast between the living standards of the most affluent and the rest of the population – but that hardly makes South Africa unique. How does the magnitude and pattern of inequality compare with other countries?
- *On the labour market and unemployment:* Certainly, the standards of living of (employed) South African workers are way below those of elites. But does that make South Africa a 'low wage' economy? Or, conversely, notwithstanding the disparities vis-à-vis the top, are South Africa's workers an overpaid 'labour aristocracy', whose 'unreasonable' demands exacerbate joblessness and poverty?
- *On the performance of the country's public sector:* Certainly, it falls short of perfection in addressing the above deep-seated challenges. But, judged against perfection, almost any human endeavour will be perceived a failure. How does South Africa's public sector benchmark against its comparators?

Underlying each of these polarised discourses is a broader question, which is central to the present paper (and the broader goals of the ESID project):

*Has South Africa's political settlement provided a constructive platform for successfully addressing the country's deep-seated economic challenges in an inclusive way? Or is it increasingly consolidating as a settlement which is narrowly of elites and for elites (albeit in importantly different ways from its apartheid predecessor)?*

To provide an empirical anchor to these debates, this paper presents data on both growth (summarily), and distribution (in depth). The aim is to locate South Africa's evolving political economy post-1994 in a comparative context across countries, as well as over time within South Africa. As an initial point of departure, Table 4 details South Africa's real economic growth since the dawn of democracy. As it shows, growth has been moderate – with a

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<sup>8</sup> In 1994, the National Party won a majority in the Western Cape (with substantial support from the province's mixed race ('coloured') population, and the Inkatha Freedom Party won a majority in Kwazulu Natal.

**Table 4: South African real annual economic growth, 1990-2013**

Year	Growth rate	Year	Growth rate
1990-1994	0.0%	2008-2010	0.7%
1994-2000	2.8%	2011	3.6%
2000-2004	3.5%	2012	2.5%
2004-2008	5.0%	2013	1.9%

gradual acceleration until the 2007/8 global financial crisis, but a lack of momentum since then. The final section of the paper will return to the subject of economic growth.

Turning to distribution, to provide an empirical anchor to the analysis, this paper contrasts South Africa with a set of countries with similar average incomes, similarly medium-to-large population size – and hence (plausibly) broadly similar development challenges, and broadly similar levels of resources to address them. (By contrast, high income countries have more developed economic structures, and vastly more resources to address their challenges.) As per Table 5, the four middle-income country comparators used in this paper are Brazil, Mexico, Thailand and Turkey. As the table shows, ‘middle’ is indeed middle: between 1992 and 2012, South Africa’s per capita income was consistently one-fifth of that of the high-income United States. Per capita income in 2012 for Kenya, by contrast, was \$1,723 – less than one-sixth that of South Africa.

**Table 5: South Africa – a middle-income country**

	South Africa	Brazil	Mexico	Thailand	Turkey	United States
<b>Population</b> 2012(millions)	51	198	117	67	74	314
<b>Per capita gross domestic product</b> (current \$; purchasing power parity)						
<b>1992</b>	5,367	5,431	8,428	3,515	6,062	25,467
<b>2002</b>	7,195	7,449	11,221	5,465	8,093	38,123
<b>2012</b>	11,281	11,747	15,363	9,502	14,811	51,703

Source: International Monetary Fund, *World Economic Outlook*.

A multi-country data set compiled by Branko Milanovic (as part of his sustained effort to compile a data set, comparable across countries, to measure trends in global inequality) provides a platform for comparing South Africa’s patterns of inequality with those of the other middle-income countries.<sup>9</sup> Milanovic draws all of his data from consumption or expenditure surveys; following Milanovic, we also use expenditure data (taken from South Africa’s five-yearly *National Income and Expenditure Survey*). The following features of these data are noteworthy:

- The data are highly disaggregated; average income is reported for each of 20 ‘ventiles’;
- The data are reported on a per capita basis – calculated (as per Milanovic) by dividing average household income by the number of household members;

<sup>9</sup> For a recent output of this research programme, see Milanovic (2012). The data on World Income Distribution (WYD) used by Milanovic are available at: <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:22261771~pagePK:64214825~piPK:64214943~theSitePK:469382,00.html>

- Consumption/expenditure surveys provide a lower estimate of inequality than other measures:
  - they (indirectly) incorporate the impact of fiscal policy, specifically of taxes and transfers – and in the South African case, fiscal policy is distributionally progressive;
  - they generally systematically under-sample the incomes from the very top of the income distribution – and thus underestimate both average incomes and the extent of inequality; and
  - they further underestimate inequality, insofar as inequalities in wealth almost always are greater than inequalities in income.

While Milanovic endeavoured to group the data by year (one goal of his work was to assess trends in global inequality between 1988 and 2008), the cycles of measurement – indeed availability more broadly – vary from country to country. The cross-country data used in this paper are for 2000-2002.<sup>10</sup> South Africa's expenditure distribution is also reported for 2005 and 2010. While ideally one would have liked comparable data for the later years from the other countries as well, the necessary disaggregated data are not available. It is worth noting, though, that data from other sources<sup>11</sup> show that, overall, inequality was relatively unchanged over the decade in Thailand and Turkey, and declined somewhat in Brazil and Mexico.

Table 6 builds on Milanovic's data for the 2000-2002 period to provide an initial overview of patterns of inequality across the five countries. Note the two estimates for South Africa: while both are based on the identical data source (South Africa's *Income and Expenditure of Households* survey for the year 2000), the final release of that data differed from an interim set of estimates – and the latter was the one used by Milanovic.<sup>12</sup> As is evident from the table, the final measures show much higher levels of inequality than did the interim measures.<sup>13</sup> While the remainder of this paper will principally use the final 2000 measures, in order to provide a consistent (uncorrected) comparative baseline with the other countries both sets are shown in Table 6.

Comparing the aggregate patterns (using the final 2000 data), South Africa emerges as the most unequal of the middle-income countries. Brazil's inequality as of 2000 is also high. Turkey and Thailand are less unequal, with Mexico in between. More than the comparator middle-income countries, South Africa confronts the dilemma laid out in Table 2 – rule-of-law

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<sup>10</sup> The South African data are from the country's 2000 *Income and Expenditure Survey*. Milanovic adjusted all data to a year 2002 benchmark, using growth and inflation measures, plus the inequality shares in the actual year measured.

<sup>11</sup> See, in particular, the 'All the Ginis' database compiled by the World Bank (available at <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:22301380~pagePK:64214825~piPK:64214943~theSitePK:469382,00.html>), and the 'World Income Inequality' database compiled by the United Nations University-WIDER (available at [http://www.wider.unu.edu/research/WIID-3a/en\\_GB/database/](http://www.wider.unu.edu/research/WIID-3a/en_GB/database/))

<sup>12</sup> The interim data, which had been provided to the World Bank for a variety of analyses, appears to have been 'trimmed' of outliers at the top end of the income/expenditure distribution.

<sup>13</sup> With the interim measures as the basis for calculation, South Africa's Gini coefficient is 0.58; using the final measures it is 0.67.

**Table 6: Aggregate inequality, 2000-2002 (% share of gross domestic expenditure)**

	South Africa (final)	South Africa (interim)	Brazil	Mexico	Thailand	Turkey
<b>Top 5%</b>	42.1%	29.0%	33.7%	27.9%	19.8%	23.1%
<b>Next 15%</b>	32.2	34.0	29.8	28.2	27.1	26.5
<b>Next 40%</b>	20.2	28.3	28.4	32.5	36.0	35.3
<b>Bottom 40%</b>	5.5	8.7	8.1	11.4	17.1	15.1
	100%	100%	100%	100%	100%	100%

Source: Milanovic (2012); Statistics South Africa, *Income and Expenditure of Households, 2000*.

competitiveness is strong, but it is premature to conclude that sustainable democracy is in place.

Table 7 updates the South African data on expenditure distribution with measures for 2005 and 2010. As the table shows, South African expenditure inequality declined somewhat over the decade. This finding needs to be qualified. For one thing, as noted above, the data are for expenditure not wealth. Asset prices adjusted upwards in the mid-2000s after economic growth accelerated, and racist doubts about the basic competence of a black ruled country diminished. As a result, asset owners (who were still almost entirely white) benefited significantly, and distribution (measured by wealth, rather than expenditure) almost surely worsened. For another thing, as the cross-country comparison underscores, it is important to distinguish between trend and level. While the trend of expenditure distribution may have improved post-2000, the impact on cross-country relativities of this change are dwarfed by the magnitude of the differences between South Africa and the other countries which prevailed as of 2000. Yet, for all of these qualifications, the fact that South Africa was able to put in place policies which, on the margin, had progressive consequences for expenditure distribution, is an important story.

**Table 7: Trends in South African income and inequality, 2000-2010**

	2000	2010	%change, 2000-2010
National real per capita income (constant 2005 Rand)	R29,798	R36,211	21.5%
	<i>Expenditure shares</i>		<i>In real per capita expenditure, by subgroup</i>
Top 5%	42.1%	37.5%	+9.1%
Next 15%	32.2	32.8	+24.3%
Next 40%	20.2	22.8	+38.0%
Bottom 40%	5.5	6.9	+52.2%
Total	100%	100%	

Sources: Income and Expenditure of Households, 2000 & 2010; International Monetary Fund, *World Economic Outlook*.

#### 4. Unbundling South Africa's patterns of inequality

This section takes a disaggregated look at South Africa's patterns of inequality. It focuses in turn on each of the poorest 40 percent of the population, the top 20 percent and the middle 40 percent. It disaggregates within each category; describes patterns of change over time; and, as useful, contrasts the disaggregated South African patterns with those of the other four middle-income countries.<sup>14</sup> These disaggregated data provide an empirical platform for assessing the hypotheses laid out earlier as to the transmission channels through which continuing high levels of inequality subsequent to the country's 1994 political settlement might contribute to downward pressure on governance.

##### 4.1 Poverty and the provision of public services

In the two decades since the advent of democracy, South Africa has made some important gains in its fight against poverty. Table 8 provides some concrete detail of the benefits achieved. Table 9 details changes in expenditure shares across deciles between 2000 and 2010. As the table shows, the gains of the bottom 40 percent were shared across all four of the bottom deciles of the distribution.

**Table 8: Changes in the provision of public services**

	1996	2011
Absolute poverty, with daily hunger	28%	11%
Access to:	58%	85%
- electricity		
- piped water	56%	91%
Immunisation coverage	68%	98%
Secondary school enrolment	50%	75%
Access to social grant (old age, child support, disability)	2.4 million	15 million
Labour-intensive public works	-	1 million jobs

**Sources:** The above data, drawn from official statistics, were collated in Goldman Sachs (2013), *Two Decades of Freedom: What South Africa is Doing With It and What Now Needs to Be Done* Available at: <http://www.goldmansachs.com/our-thinking/archive/colin-coleman-south-africa/20-yrs-of-freedom.pdf>

In the 1990s, redistribution largely took the form of the extension of services to the poor. The Reconstruction and Development Programme (RDP) which began in 1994 had built more than 1.5 million houses for the poor by 2003. Access to potable water grew from 60 percent to 80 percent of households between 1998 and 2003, and access to electricity grew from 50 percent to 70 percent of households between 1994 and 2000. Immunisation coverage grew

<sup>14</sup> For another analysis of trends in South African income distribution over the two decades since 1994, see Seekings (2013).

**Table 9: South Africa's evolving expenditure shares within the bottom deciles, 2000-2010**

	2000	2005	2010
7 <sup>th</sup> decile	2.1%	2.4%	2.6%
8 <sup>th</sup> decile	1.6	1.9	2.0
9 <sup>th</sup> decile	1.2	1.5	1.4
10 <sup>th</sup> decile	0.6	0.9	0.9
<b>Bottom 40%</b>	5.5%	6.7%	6.9%

Source: Statistics South Africa, *Income and Expenditure of Households*, multiple years.

from about 68 percent in 1996 to 90 percent by 2005.<sup>15</sup> Other interventions included the introduction of small amounts of 'free basic' water and electricity for all households.

A second phase of redistribution to the poor started in the late 1990s and picked up speed as government finances strengthened in the 2000s. The Child Support Grant – the main form of support for indigent families – was introduced in 1998 and already reached 3 million children by 2003. By 2010, after the maximum eligibility age was raised several times, more than 10 million of the poorest children in a country with a total population of less than 50 million at that time were receiving child support grants. Social security transfers rose to 3.5 percent of GDP by 2009, representing a concerted attempt to ameliorate severe poverty, in the absence of comprehensive unemployment insurance.<sup>16</sup>

But for all of the above gains, there are some stark limitations as to what has been achieved at the bottom of South Africa's distributional pyramid. The poorest four deciles are largely unemployed and are often in the rural areas designated 'reserves' or 'homelands' in the apartheid era, but they are also found in informal settlements around towns and cities. Many of these informal settlements are poorly integrated into the social life of the towns and cities. So, gains for the poorest 40 percent were achieved without much alteration of their difficult underlying realities.

#### **4.2. Elites and the (upper) middle class**

This sub-section explores the opposite end of the distributional spectrum – the patterns of distribution within the affluent top quintile of the population. It aims to shed both qualitative and quantitative light on the relative position of this economic tier. Qualitatively, it reviews briefly the economic history of elite affluence, and its evolution post-1994. Quantitatively, it contrasts South Africa's pattern within the top quintile of the distribution with that of other countries. It then goes on to review changes in the patterns of distribution within the South African elite in the period subsequent to the 1994 dawn of democracy – both in the ethnic composition of the elite, and in the patterns of distribution across ventiles.

<sup>15</sup> Development Indicators 2012, Department of Performance Monitoring and Evaluation, The Presidency, 2013, various tables.

<sup>16</sup> *The South African Child Support Grant Impact Assessment; Evidence from a Survey of Children, Adolescents and their Households*, Department of Social Development, South Africa and Unicef, undated, [http://www.dsd.gov.za/index2.php?option=com\\_docman&task=doc\\_view&gid=285&Itemid=39](http://www.dsd.gov.za/index2.php?option=com_docman&task=doc_view&gid=285&Itemid=39)

For all of the efforts described in the previous sub-section to direct resources towards the hitherto excluded majority of the country's population, the 1994 political settlement was also favourable to both pre-existing and emerging elites. One benefit, noted earlier, came from the upward re-pricing of assets. Further, as economic growth accelerated, the shortage of skills, still primarily a legacy of apartheid, benefited whites greatly in the form of an unusually high salary premium for skilled professionals. Additionally, in the course of the implementation of reform programmes, radical notions of 'transformation' were supplanted: transformation virtually became a synonym for affirmative action and the partial transfer of assets of existing companies to black individuals and groups in empowerment programmes. Finally, while some efforts were made at land distribution, its outcomes were less than dramatic, due to various limitations on government's capacity to act.

As Table 10 underscores, South Africa's skewed distribution is evident both in the startlingly high share of the top 5 percent (in the final 2000 survey), and also in the disproportionately high share of the second and third ventiles. The reasons for this 'thickness' of South Africa's pattern of elite privilege are rooted in South Africa's history – in particular in how the country's political economy played out within the white minority population (which, for much of the apartheid era, accounted for about one-fifth of the country's population). Specifically, for much of the 20th century, and accelerating with the election of the National Party government in 1948, a central preoccupation of the (white minority) South African government was to restructure patterns of income distribution within the white population by improving the levels of living of the relatively poorer segments of the white population, and by creating new opportunities for an emerging Afrikaner business class.

**Table 10: Income distribution within the top 20 percent, 2000-2002**  
(% share of GN expenditure)

	<b>South Africa</b> (final)	<b>Brazil</b>	<b>Mexico</b>	<b>Thailand</b>	<b>Turkey</b>
<b>Top 5%</b>	42.1%	33.7.0%	27.9%	19.8%	23.1%
<i>2<sup>nd</sup> ventile</i>	15.6	13.6	12.1	11.1	10.9
<i>3<sup>rd</sup> ventile</i>	9.9	9.2	9.0	8.7	8.5
<i>4<sup>th</sup> ventile</i>	6.7	7.0	7.1	7.3	7.1
<b>Next 15%</b>	32.2%	29.8%	28.2%	27.1%	26.5%

Source: Milanovic (2012); Statistics South Africa, *Income and Expenditure of Households*.

A variety of discriminatory public policies were used to achieve the goal of economic 'upliftment' within the white minority. These included:<sup>17</sup>

- labour legislation which restricted skilled blue collar employment to white workers;
- controls on the migration of black South Africans to cities;
- large-scale employment of unskilled white workers in the public sector, at relatively high-wage levels; and

<sup>17</sup> For details, see Lipton (1986); Seekings and Nattrass (2005); O'Meara (1983; 1996); Giliomee (1978); and Crankshaw (1997).

- preferential access to public sector procurement, and other public favours to Afrikaner-owned businesses; and, more broadly
- an effective welfare state for white South Africans, including major public investments in human capital, via differential access to high quality (and subsidised) public education at primary, secondary and tertiary levels.

As the data in Table 10 suggest, viewed from the perspective of the economic purpose of the apartheid state, these policies achieved their goals. But the result was also the locking-in of an exclusionary economy which (by intent, during the apartheid years) was singularly bad at creating opportunity for the country's black majority.<sup>18</sup>

The 'success' of apartheid for South Africa's white minority citizens has an important implication for understanding the character of South Africa's 1994 political settlement. By the latter years of apartheid, white South Africans had become less dependent for their privileges on discriminatory labour legislation, which was phased out over the course of the 1980s. Indeed, as of 1993, well under 10 percent of the economically active white population was employed in blue collar work (Seekings and Natrass, 2005: 259). The employed formal working class had become predominantly black/African. In consequence, the incentives of the white protagonists of South Africa's political settlements were principally those of a pro-business (though not necessarily, pro-market) elite.

Post-1994, there have been two noteworthy changes in the relative economic position and internal composition of the top two deciles. First, as Table 11 shows, there has been some decline in the share of the top 5 percent, though the fundamental reality of deep inequality persists. More striking is the ongoing evolution in the composition of the elite.

**Table 11: Distribution of expenditure within South Africa's elite, 2000-2010**

	2000	2005	2010
<b>Top 5%</b>	42.1%	41.3%	37.6%
2 <sup>nd</sup> ventile	15.6	15.9	15.9
3 <sup>rd</sup> ventile	9.9	9.5	10.0
4 <sup>th</sup> ventile	6.7	6.3	6.9
<b>Top 20%</b>	74.3%	73.0%	70.4%

Source: Statistics South Africa, *Income and Expenditure of Households*.

At the time of the political transition, the ANC was ambivalent on the issue of 'black economic empowerment' (BEE) as its tradition and the 1994 election manifesto promoted a far broader view of economic transformation. By the late 1990s a firm commitment to empowerment emerged, for the first time in a resolution at the ANC's five-yearly conference in Stellenbosch in 1997. These BEE policies have been amended over time.<sup>19</sup> As of the latter part of the first 2000s decade, their key features included the following:

<sup>18</sup> This point is developed in detail in Natrass and Seekings (2005).

<sup>19</sup> For an overview of how South Africa's BEE policies have evolved, see Butler (2011); also Hirsch (2005), chapter 6; for an assessment of the impact of BEE on corporate strategy and policy, see Acemoglu, Gelb and Robinson (2007).

- Preferential government procurement and a number of government and state-owned-enterprise funded support programmes for black business or the transfer of ownership to black people;
- Accelerating Africanisation of the civil service;
- A series of industry-based charters committing to various forms of transformation, including subsidised transfers of share ownership, promotion of black technicians, professionals and managers through affirmative action and training and preferential procurement to black-owned companies;
- Some of these charters were recognised by the 2003 Broad-based Black Economic Empowerment Act, which provided a framework for empowerment and a scorecard that could influence commercial relationships with other businesses and the public sector;
- Some industries had industry-specific empowerment laws like the Mineral Resources Petroleum Industry Development Act;
- State-owned enterprises and large private companies in the public eye tended to reinforce empowerment initiatives.

Changes in the system responded to both abuses such as fronting, where black people were used as fronts for white owners, and to impatience with the slow pace of change or the narrowness of the group of beneficiaries of BEE.

To what extent have these BEE policies transformed the ethnic composition of South Africa's economic elites? Table 12 begins to answer this question. It unbundles the ethnic composition of the elites for two points in time, 1995 and 2010; for each year, it reports on the number of people within each of three broad groups whose per capita incomes are in excess of the mean per capita income (pcY)<sup>20</sup> for the country and, within, that fall within the top 10 percent of earners. (Note that, given South Africa's very unequal distribution, the mean is well above the median; in each period, 23-24 percent of the population have incomes in excess of the mean per capita income [pcY].) Four patterns are noteworthy:

- First, as of 2010, the white minority continued to comprise the majority of earners in the top 10 percent of the distribution – 56 percent of the total, down from 71 percent in 1995. Indeed, as of 2010, earnings of 60 percent of the white minority population were in this top 10 percent.
- Second, the number of black South Africans in the top 10 percent rose by 70 percent – from 871,000 in 1994 to 1,481,000 in 2000. (The proportionate gains were greater among other ethnic groups.)

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<sup>20</sup> Note the reference to 'mean per capita income' rather than a specific amount. The reason is that (as is also the case in other countries, and is discussed further in Annex A) estimates of mean pcY are very different according to national accounts statistics, and calculations based on income and expenditure household surveys. The note to Table 12 lists some alternative pcY measures from which readers can choose. For present purposes, the principal focus is on relative earnings – and here the principal risk of household surveys is that they underestimate returns from wealth, and hence underestimate the extent of inequality.

**Table 12: The ethnic composition of South Africa's elite, 1995 and 2010**

	1995		2010	
	Number (000s)	Percentage	Number (000s)	Percentage
<b>Among 'whites'</b>				
Total population	5234	13%	4651	9%
Top 10% of per capita incomes	2938	56%	2805	60%
Income above mean pcY, but not in top 10%	1804	34%	1253	27%
Income above mean pcY in 1995, but below mean pcY in 2010			238	5%
Income below mean per capita income in 1995	492	9%	355	8%
<b>Among 'blacks'/'Africans'</b>				
Total population	31727	76%	40001	79%
Top 10% of per capita incomes	871	3%	1481	4%
Income above mean pcY, but not in top 10%	3028	10%	3883	10%
Income above mean pcY in 1995, but below mean pcY in 2010			2199	5%
Income below mean per capita income in 1995	27828	88%	32439	81%
<b>Among other groups ('Coloureds' and 'Asians/Indians')</b>				
Total population	4599	11%	5771	11%
Top 10% of per capita incomes	347	8%	763	13%
Income above mean pcY, but not in top 10%	1064	23%	1425	25%
Income above mean pcY in 1995, but below mean pcY in 2010			587	10%
Income below mean per capita income in 1995	3188	69%	2996	52%

Sources: *Income and Expenditure of Households*, 1995 and 2010. National accounts data in the note below are from IMF, *World Economic Outlook*.

Note: As per footnote 30, estimates of per capita incomes vary depending on whether national account statistics or household surveys are used. Using household surveys, the mean per capita incomes in current prices were R9,300 in 1995 and R31,086 in 2010 (R27,951 and R38,230, respectively, using 2014 prices). Using national accounts statistics, the mean per capita incomes in current prices were R13,620 in 1995 and R52,534 in 2010 (R40,935 and R64,564, respectively, in 2014 prices). In current (i.e. 1995 and 2010) dollars, using national accounts data, per capita incomes were \$3,755 in 1995 and \$7,175 in 2010; using purchasing power parity rather than nominal exchange rates, the equivalent measures were \$5,908 and \$10,289, respectively.

- Third, there have been major gains in the number of black South Africans who earn above a benchmark of 1995 pcY – from 3.9 million in 1995 to 7.6 million in 2010. (It is the growth of this tier that has been written about enthusiastically, as signifying the economic transformation of South African society.)<sup>21</sup> But

<sup>21</sup> For a discussion of the misuse of the term 'middle class', see Visagie (2013).

- Fourth, consistent with the broader pattern of inequality, over 80 percent of black South Africans continue to live in households with per capita incomes below this 1995 pcY threshold – and the majority in households with incomes substantially below the threshold.

But overall, for all of the effort made, the pace of change at higher levels of income has been slow, and the majority of the white population continues to maintain its far-reaching economic privilege. The rate at which opportunities for entering the economic elite have opened up has lagged the pace of political change. As per the hypotheses laid out earlier, this has set the stage for politically connected individuals to work around impersonal, rule-bound systems – and seek access to elite status via the discretionary manipulation of public procurement ('tenderpreneur-ship'), and the use of personalised, patronage channels to access top-tier public sector jobs and elected positions (MISTRA, 2013; Netshitenzhe, 2012).

### **4.3. The middle 40 percent – workers and the un(der)employed**

A focus on the 'middle' 40 percent of the income distribution is salient for both a general and a South Africa-specific reason. The general reason is that it is in this segment that the 'median' earners are to be found – and there is an abundant literature which identifies this (statistically genuine) 'middle' class as a key buttress of democracy.<sup>22</sup> The South Africa-specific reason is that, in negotiating the country's political settlement, the African National Congress functioned as an alliance, one which incorporated not only the ANC itself, but also the Congress of South African Trade Unions (COSATU) and the South African Communist Party. In the South African context, as Seekings and Nattrass (2006) have shown, in the early 1990s the large majority of formal sector, unionised blue collar workers were located in this 'middle' 40 percent. Further, (and also as per Seekings and Nattrass, 2006), as of 1993 close to 85 percent of the core working class already was black/African. Understanding how this 'middle' 40 percent segment of South Africa's population has fared post-apartheid is thus central to understanding more broadly how South Africa's political settlement is evolving.<sup>23</sup>

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<sup>22</sup> For an important recent contribution to this literature, see Acemoglu and Robinson (2006). Important earlier arguments along these lines include Lipset (1959: 69-105); Huntington (1968; 1991); and Moore (1966).

<sup>23</sup> Seekings and Nattrass (2006: 246-260) decompose where different occupational categories were located in South Africa's *household* income distribution in 1993, by deciles and by ethnic composition. For present purposes, the relevant category is their 'core working class' -- which they define as households whose principal earner comprises 'semiskilled and unskilled workers (except farm and domestic workers)', which account for 19 percent of all households. They report that as of 1993, 70 percent of all core working class households were located in the distributional range spanning the 3rd (from the top) to the 6th deciles. Note that since, as per Annex Table A1, the most affluent households are disproportionately small, and the least affluent are disproportionately large, ordered on a per capita basis the distributions of core working class households are somewhat more skewed towards the upper end of the income distribution than their data suggest.

**Table 13: Comparative distribution within the middle 40 percent, 2000/2 (% of GNExp)**

	<b>South Africa</b> (final)	<b>Brazil</b>	<b>Mexico</b>	<b>Thailand</b>	<b>Turkey</b>
5 <sup>th</sup> ventile	4.8%	5.7%	6.0	6.3	6.2
6 <sup>th</sup> ventile	3.6	4.7	5.1	5.6	5.5
7 <sup>th</sup> ventile	2.9	4.1	4.6	5.0	4.9
8 <sup>th</sup> ventile	2.4	3.5	4.1	4.5	4.4
9 <sup>th</sup> ventile	2.0	3.1	3.7	4.1	4.1
10 <sup>th</sup> ventile	1.7	2.8	3.3	3.8	3.7
11 <sup>th</sup> ventile	1.5	2.4	3.0	3.5	3.4
12 <sup>th</sup> ventile	1.3	2.1	2.7	3.2	3.1
<b>Middle 40%</b>	<b>20.2%</b>	<b>28.4%</b>	<b>32.5%</b>	<b>36.0%</b>	<b>35.3%</b>

Source: Milanovic (2012); Statistics South Africa, *Income and Expenditure of Households*.

Table 13 above contrasts the 2000-2002 distributions within the 'middle 40 percent' for South Africa and the four other middle-income countries. Considered together with Table 8, a striking pattern emerges. Whereas the expenditure share of South Africa's 3rd ventile is higher than that of all the other countries, by the 5th ventile, the South African share is the lowest of the group – with a disproportionately rapid rate of decline among the next few ventiles as well. Within the top third of South Africa's distribution, there is a startling cliff between higher and lower earners.

Figure 3 below visually illustrates the starkness of South Africa's distributional cliff, as of 2000, relative to that of the four other middle-income countries – it normalises (to a value of 1) the income share of the 3rd ventile across countries, and shows the differential rates of cross-country decline from the 3rd to 7th ventiles, relative to the normalised 3rd ventile.

Table 14 offers a comparative summary statistic. As per the table, South Africa's average per capita expenditure in the 7th ventile is only 29 percent that of the 3rd ventile. In Turkey, by contrast, earners in the 7th ventile spend 58 percent of those in the 3rd. Thailand, Mexico and Brazil are in between – but closer to the Turkish pattern. Focusing on the differential in the bottom part of the cliff – that is, between the 5th and 7th ventiles – a similar pattern of a steeper South African cliff also is evident. Relative to other middle-income countries, South Africa's households are thus either (relatively) affluent or poor – with relatively few positions which provide a 'stepladder' for moving incrementally from one economic stratum to another.

**Table 14: South Africa's distributional cliff (7th ventile income relative to 3rd ventile, 2000)**

	<b>South Africa</b>	<b>Brazil</b>	<b>Mexico</b>	<b>Thailand</b>	<b>Turkey</b>
7 <sup>th</sup> /3 <sup>rd</sup> ventile (ratio)	0.29	0.45	0.51	0.57	0.58
7 <sup>th</sup> /5 <sup>th</sup> ventile	0.60	0.72	0.77	0.79	0.79

Source: Calculated from data in Tables 7 and 10.

**Figure 3: Rate of decline of income shares, 3rd -16th ventile (3rd normalised at 1)**

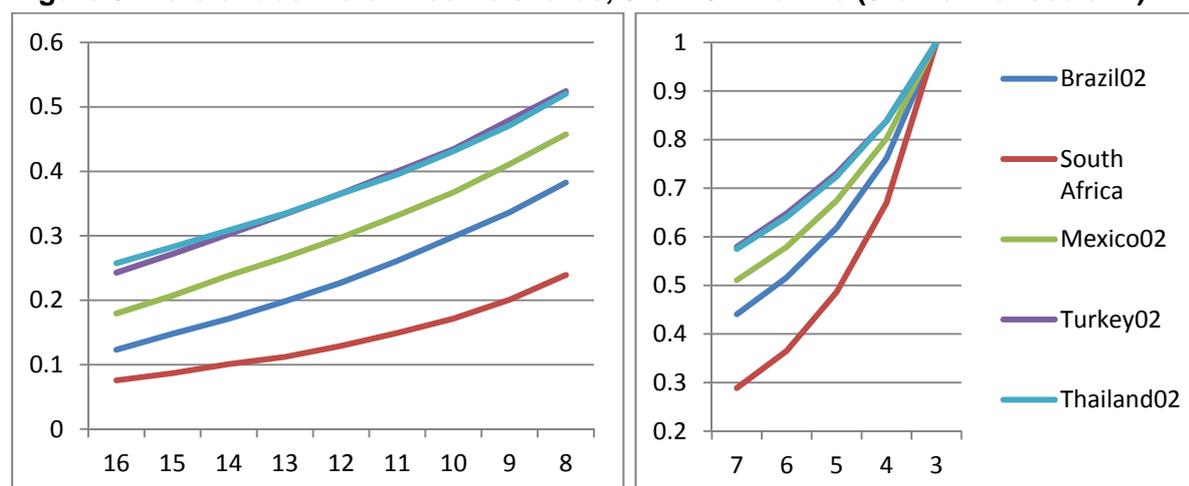


Table 15 updates the South African data for 2005 and 2010. As per these data, since 2000 the steepness of South Africa's distributional cliff has moderated somewhat – the 2010 ratio of the 7th to 3rd ventile is 0.33 (up from 0.29); and the ratio for the 7th to 5th ventile is 0.65 (up from 0.60). However, even in 2010, from the fourth ventile down, South African expenditure shares decline more rapidly – and remain sharply below – those of the other countries, with the cliff correspondingly steeper.<sup>24</sup>

**Table 15: Changing distributional shares of South Africa's 'middle 40 percent', 2000-2010**

	2000	2005	2010
5 <sup>th</sup> ventile	4.8%	4.6%	5.1%
6 <sup>th</sup> ventile	3.6	3.6	4.1
7 <sup>th</sup> ventile	2.9	2.9	3.3
8 <sup>th</sup> ventile	2.4	2.4	2.7
9 <sup>th</sup> ventile	2.0	2.1	2.3
10 <sup>th</sup> ventile	1.7	1.8	2.0
11 <sup>th</sup> ventile	1.5	1.6	1.8
12 <sup>th</sup> ventile	1.3	1.5	1.5
<b>Middle 40 %</b>	<b>20.2%</b>	<b>20.5%</b>	<b>22.8%</b>

Source: Statistics South Africa, *Income and Expenditure of Households*.

The historical origins of this pattern are rooted in the exclusionary, mining- and capital-intensive development path of South Africa's apartheid economy. But two decades into the country's democratic settlement these exclusionary patterns have persisted, indeed in some

<sup>24</sup> As noted earlier, only South Africa has disaggregated data available for 2010; data for the other countries are for 2000. However, as noted in Section 3, in both Brazil and Mexico (the countries closer to South Africa) inequality has declined somewhat since 2000. While distributional patterns in Thailand and Turkey barely changed at all, as of 2000 their difference with South Africa in cliff steepness was especially stark. Hence the conclusion in the text on the continuing differences between South Africa and the other middle-income countries.

ways accelerated – the share of households where the principal earner was employed as part of the core, formal sector working class has fallen from 19 percent in 1993 to 10 percent in 2008 (Seekings, 2015: 8). In part, this shift reflects broader changes in the global distribution of labour and the shift of blue collar work to China and other Asian countries. But the shift also is consistent with a change in the composition of workers that are members of COSATU-affiliated unions (COSATU, as noted, has been one of the main pillars of the ANC's tripartite ruling alliance).

As of 1994, unskilled and semi-skilled workers comprised 60 percent of COSATU members; by 2008, their share had fallen to 22 percent. Two decades later, skilled workers comprised 39 percent of COSATU members (up from 21 percent in 1994) – and professionals (overwhelmingly in the public sector) 20 percent, up from close to zero in 1994.<sup>25</sup> These patterns are consistent with the hypothesis suggested earlier that, in the context of a labour market segmented between 'insider' and 'outsider' groups, upper tiers of workers would be more likely to translate their political influence into sustained economic gains. The emergence of a breakaway union and protracted strike among unskilled platinum mineworkers is a symptom of this tension.

Table 16 overleaf uses data from South Africa's 2010 income and expenditure survey to decompose the cliff into three distinct component parts: changes in average earnings of the principal income earner in a household; changes in all other sources of household income; and changes in household size. (Annex A explores and adjusts for some well known limitations<sup>26</sup> of these data; Annex Table A1 provides the disaggregation across the entire distribution.) Three patterns are highlighted.

First is the influence of household size. Large household size is commonly suggested as an explanation for rapid rises in poverty below the top of the income distribution. As the third column of Table 16 (and Annex Table A1) underscore, there is indeed a clear correlation between lower average per capita incomes and increases in average household size. But the contribution of increases in household size to poverty becomes large only in the bottom half of the income distribution; average household size remains relatively small, even in the 8th ventile.<sup>27</sup>

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<sup>25</sup> Data are from Seekings (2013) and (2014). Seekings, in turn, draws on Bischoff and Tshoedi (2012).

<sup>26</sup> Crucially, reported income from the 2010 Income and Expenditure Survey (IES) appears to be a substantial underestimate. To illustrate: as of 2010, the 5th ventile accounted for 5.1 percent of per capita income; so mean per capita income in that ventile should be approximately equal to mean per capita income. However, while per capita income (in current 2010 Rands) was R52, 534, reported per capita income for the ventile, based on the IES earnings reports and as per Table 13, was R28,404. However, any systematic bias in these downward estimates across earners or by income ventile is likely to be limited. For present purposes, the data in Table 13 are presumed to comprise unbiased estimates of the relative shares of income from different sources, and of changes across ventiles.

<sup>27</sup> Note, though, that all the earnings measures in Table 16 are averages; there surely are some very large households with a single, relatively well paid earner, but overall household poverty – but, as is evident from the table, such instances are exceptions to the average pattern.

**Table 16: Decomposing South Africa's distributional cliff I (2010 Rands)**

	<b>Average annual earnings of largest income earner</b>	<b>Average earnings per household from all other income sources</b>	<b>Average size of household</b>	<b>Average annual per capita income</b>
3 <sup>rd</sup> ventile	122,045	41,281	2.86	57,039
4 <sup>th</sup> ventile	90,110	31,188	2.88	42,051
5 <sup>th</sup> ventile	65,880	20,185	3.03	28,404
6 <sup>th</sup> ventile	56,054	18,517	3.13	23,827
7 <sup>th</sup> ventile	41,220	14,921	3.26	17,237
8 <sup>th</sup> ventile	34,695	11,330	3.41	13,484
11 <sup>th</sup> ventile	27,537	10,782	4.02	9,532
18 <sup>th</sup> ventile	15,185	9,853	5.96	4,201

Source: Source: Statistics South Africa, *Income and Expenditure of Households 2010/11*.

Second, the distributional cliff is in part a consequence of the widely acknowledged South African reality of a low share of the population being economically active, and an associated weakness of the informal sector – with the consequence that the economic contributions of other household members may be proportionately lower in South Africa than elsewhere. In contrasting the South African pattern with those of other countries, key empirical questions might include:

- From the 3rd ventiles down, to what extent do 'average household earnings from all other sources' comprise a lower share of total household income in South Africa than in other middle-income countries?
- What are these 'other sources'?
- To what extent is the level of household income from these 'other sources' more stable across distributional classes than is average earnings of the largest income earner?

Estimation of the relevant magnitudes must await detailed, empirical comparative cross-country research of a kind which is beyond the scope of the present effort.

Third, comparative analysis provides insight into the ongoing controversy as to whether South Africa's 'blue-collar' work force is high-wage or low-wage – and, thus, more broadly into the nature of the country's deep-seated problem of structural unemployment.<sup>28</sup> In part, the answer to the high-versus-low wage conundrum depends on the relationship between earnings and productivity, an issue which goes beyond the scope of this paper. Robust comparative benchmarking also would require the results of the comparative research suggested above on patterns of income from 'all other sources'. But, even recognising these limitations, some striking preliminary implications can be drawn from a 'thought experiment' based on the data laid out in this paper.

<sup>28</sup> For a further discussion and detailed empirical investigation of this issue see Seekings (2014).

The distributional cliff implies, by definition, that relative to the other countries, average earnings of the largest income earner in a South African household decline disproportionately rapidly as one moves from the 3rd to the 7th ventile. A primary earner at, say, the 33rd percentile of the South African distribution (i.e. still within the top third) earns (controlling for differences in per capita income) about the same average wage as a median earner in comparable, constructed estimates for Mexico and Turkey. The steepness of the decline signals that what distinguishes South Africa from the other middle-income countries is the combination of disproportionately high earnings for highly skilled workers, and the extreme paucity of jobs that pay in the 'middle range' of earnings – i.e. the range currently earned by South Africa's primary household earners within the 4th-7th distributional ventiles. Annex A explores what this 'middle range' might be (in terms of monthly Rand earnings); it also highlights the limitations (given current data) of coming up with a robust measure. But, irrespective of the specific estimate, the central point remains the same: In South Africa about 12.5 percent of the jobs of primary household earners fall within the 'middle range' of earnings. By contrast, the equivalent share for Mexico is about 22.5 percent; in Turkey more than 25 percent of jobs of primary household earners are in the relevant range.

A 'missing middle' of jobs in the 'middle range' of earnings is consistent with a familiar feature of South Africa's labour market – measured unemployment rates of well above 20 percent among the economically active population. It also is consistent with some familiar explanations of South Africa's labour market travails:

- low labour productivity, per unit of capital (which is, in turn, in part a consequence of chronic underinvestment in human capital in the country's black population over many generations);
- path dependence of a capital-intensive industrial structure (another legacy of apartheid); and
- conflict-ridden industrial relations, which enable some unionised workers to lift themselves up from the lower parts of the distributional cliff – but raise the cost (in terms of both earnings and conflict) of employing workers, and thereby contribute to undercutting economic dynamism in the mid-range of the labour market.

In sum, relative to other middle-income countries, South Africa has an unusually small fraction of the population that gains directly from sustained economic growth, driven (in the first instance) by expansion of the formal economy. In the other middle-income countries, earners at the mid-point of the country's distribution – where, as per Acemoglu and Robinson (2006) there is something of a tipping point as to whether or not democracies are sustained – gain directly from economic growth (albeit at much lower levels of earnings than the current expectations of South African workers). But in South Africa opportunity tails off within the top third of the distribution. There are few opportunities (other than via political connections) for those at the bottom of the distributional cliff to incrementally and cumulatively improve their economic circumstances.

## **5. Stresses and strains – can the centre hold?**

This final section steps back from the empirical details and take a broader view. It pulls together the strands of analysis from previous sections into a summary overview of trends in South Africa's political settlement in the two decades since the dawn of democracy. It draws on recent global comparative work on the interactions between governance and growth, to explore what the emerging trends might portend going forward.

### **5.1. South Africa's political settlement after two decades of democracy**

In its first two decades of democracy South Africa has been ruled by an inclusive political alliance, which has governed within the framework provided by a robust constitutional order. However, as the country begins its third decade of democracy, the challenges of holding the centre have become increasingly difficult – and the responses are beginning to put strain on the formal institutions of governance.<sup>29</sup>

A central argument of this paper is that a major cause of these strains lies in the country's stark inequality. But there also are other contributory factors – of which a key one may be the dominance of a single political party (notwithstanding the formal structures of constitutional democracy). The absence of genuine political competition reduces the pressure on the governing party to deliver on its political promises. For another, sustained, consolidated control over the levers of power, and public resources, provides an abundance of opportunity to use those levers in discretionary ways, as a means of locking in networks of influence and deepening the ruling party's hold over power. (But note also a counter-argument – especially in a setting as unequal and politically fraught as South Africa – a de facto dominant party provides a mechanism for resolving conflict in a way which reduces the risk of demagogic populism.)

As we have seen, the causal mechanisms that link inequality and erosion of governance appear to be evident vis-à-vis all three broad distributional groups examined in Section 4 – but the specifics of how the mechanisms work vary from group to group. Consider first the top 20 percent of the distribution. Here the principal political economy challenge has been one of de-racialisation of employment, of asset ownership and of business opportunity. A first round of steps were relatively easy to take: equity-sharing arrangements with incumbent businesses on a largely voluntary basis; rapid expansion of black employment in middle management; and a transformation of the racial composition of public employment. For the first, say, 15 years of democracy, these together provided sufficient opportunity to meet the economic as well as political aspirations of a 'first generation' of skilled, politically liberated, and influential black South Africans'.

But how might the process of elite formation continue once the 'low hanging fruit' has been plucked? As Table 12 underscored, the gains have remained relatively narrow – and, though the easy opportunities may have been fully realised, a 'sold out' sign hardly is an adequate response to those (including new generations coming of age) whose aspirations were not met in the initial rounds of black empowerment. Viewed from this perspective, the rise of

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<sup>29</sup> For a rich description of the rising challenges confronting constitutional governance in South Africa, see Calland (2013); Booysen (2011); and Marais (2011).

three 'second generation' channels for responding to these aspirations – the discretionary allocation of public procurement contracts through informal channels ('tenderpreneurship'); personalised channels for accessing public employment; and factionalised contestation for nomination to elected positions in the country's many local governments – is unsurprising. However, each of these poses a difficult new set of challenges for public sector governance. (Also noteworthy, given the continuing racial disparities evident in Table 12, has been the relative absence, in the first two democratic decades, of explicitly racial populism in the elite-formation discourse.)

Turning to the next 40 percent, *a priori* one might have expected that a democratic political settlement would lead to a cumulative expansion of economic opportunity to an increasing proportion of the population. This has happened only on the margin. High levels of unemployment and relatively low earnings from the 7th-8th ventile down (as detailed in Annex A), suggest that, as discussed earlier, only upper tiers of workers have been successful in leveraging political democracy, and influence within the ruling ANC alliance, into sustained economic gains. The protracted labour conflicts in the platinum mining industry – including the longest and most economically costly strike in the country's history, with unskilled workers led by a union outside of the COSATU umbrella – offer a preview of what could be the economic and political consequences of a crumbling of the ANC's governing coalition.

For the bottom 40 percent, as Table 8 summarised, in the first two decades of democracy the gains of enhanced access to public services, temporary public employment, and social grants were substantial – but poverty (though no longer extreme poverty) remained widespread. Again, though, these gains can be viewed as 'low-hanging-fruit' – and it is not obvious how they might be followed up on economically. One facet of an emerging (political) response may be coming into view. As noted earlier, this bottom 40 percent of the population is disproportionately rural – and, strikingly, it was in rural areas (especially the former bantustans) that in 2014 the ruling ANC won its highest share of the votes in the national elections. In part, this could be a result of continuing appreciation of what has been gained. But also striking (and, also, a striking echo of the past) is the determined, consistent and successful efforts of recent ANC administrations to address the concerns of traditional leaders – even where these seemingly conflict with some of the more progressive features of South Africa's democratic constitution.

Taken together, the cumulative impact of the mechanisms of political management outlined above may be greater than the sum of their parts. Might it be possible that what we are witnessing is the triumph of path dependence over political democracy – that what is coming into view is the reconstitution (albeit no longer on racial lines) of a *de facto* exclusionary political order, one where the rules of the game are skewed to benefit insider elites, with patronage-based control the *de facto* basis for political stability?

Table 17 contrasts South Africa's governance reversals with those of the comparator middle-income countries. As it shows, notwithstanding the seemingly large scale of South Africa's reversals, as of 2012 the quality of South African governance in both dimensions remains among the best of the group. The table thus suggests a different framing of the question of

what comes next: are some of the governance challenges which have arisen over the past two decades something of a 'regression to the mean' – a South African variant of a familiar pattern (analysed in detail by Mushtaq Khan<sup>30</sup>) whereby low- and middle-income countries use patronage to target relatively limited public resources to consolidate ruling political coalitions? Or do the trends risk accelerating – and in time come to threaten the economic and political gains of the past two decades?

**Table 17: South Africa and comparators – governance percentile rank (100=best)**

	South Africa	Brazil	Mexico	Thailand	Turkey
<b>Government effectiveness</b>					
1996	79	51	59	63	57
2002	74	59	62	64	59
2012	64	50	63	61	65
<b>Control of corruption</b>					
1996	79	56	38	50	45
2002	69	55	51	48	32
2012	54	56	43	47	63

Source: Worldwide Governance Indicators.

## 5.2: Governance and development – virtuous circles and vicious spirals

In a textbook definition, legitimacy 'involves the capacity of a political system to engender and maintain the belief that existing political institutions are the most appropriate and proper ones for the society' (Lipset, 1983: 64). Francis Fukuyama expands on this: "Political power", he suggests,

"... is ultimately based on social cohesion. Cohesion may arise out of calculations of self-interest, but simple self-interest is frequently not enough. Political power is the product not just of the resources and numbers of citizens that a society can command but also the degree to which the legitimacy of leaders and institutions is recognized.... Legitimacy means that the people who make up the society recognize the fundamental justice of the system as a whole and are willing to abide by its rules.... It has to be understood in terms of the ideas people hold about god, justice, man, society, wealth, virtue and the like" (Fukuyama, 2012: 42-43, 445).

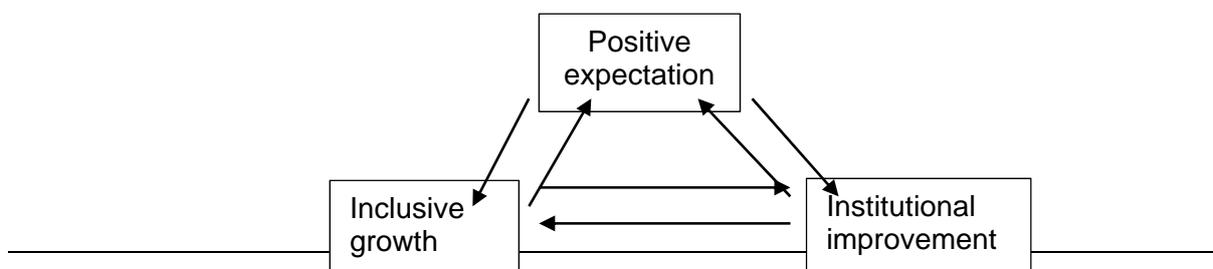
At the heart of South Africa's democratic miracle has been hope – the expectations of the large majority of the population that a better future lays ahead. The stability of the country's new democracy has been underpinned by a seemingly contradictory combination of, on the one hand, a robust constitution anchored in the rule of law, with strong checks and balances against the abuse of state power and, on the other, de facto dominance by the ANC, which in the first decades of majority rule enjoyed an unchallengeable electoral majority by virtue of its ability to position itself as the party which liberated the black majority from the yoke of apartheid.

<sup>30</sup> See Khan and Jomo (2000); also Khan (2013).

Two decades later, the realities are increasingly hitting home of an economy which lacked dynamism, of limited job opportunities in the formal sector, of increasing discontent with the quality of public service provision – and, more broadly, of emerging tensions between formal rule-bounded and patronage forms of governance. The optimism which accompanied the South African miracle has been fading. What if citizens cease viewing the rules of the game as ‘legitimate’, but begin to see them as another stacked deck? What if hope disappears?

One way to think about these questions is in terms of the interaction among three mutually reinforcing sub-circles, illustrated in Figure 4 below.<sup>31</sup> A first sub-circle links institutional improvements and inclusive growth. In this sub-circle, improvements in the provision of public services, plus gains in investor confidence, strengthen the business environment, and support continuing economic growth. Sustained growth, in turn, leads to a stronger private sector and a growing middle class, which generates new pressures and incentives to strengthen institutions.

**Figure 4: Virtuous development circles**



A second sub-circle links growth and expectations. The promise implicit in inclusive growth is one of hope, of continually expanding access to economic opportunity, of a growing middle class, and a better future for all. Growth can thus provide a powerful platform of legitimacy. And the resulting sense of confidence that things are on the move can, in turn, further spur growth.

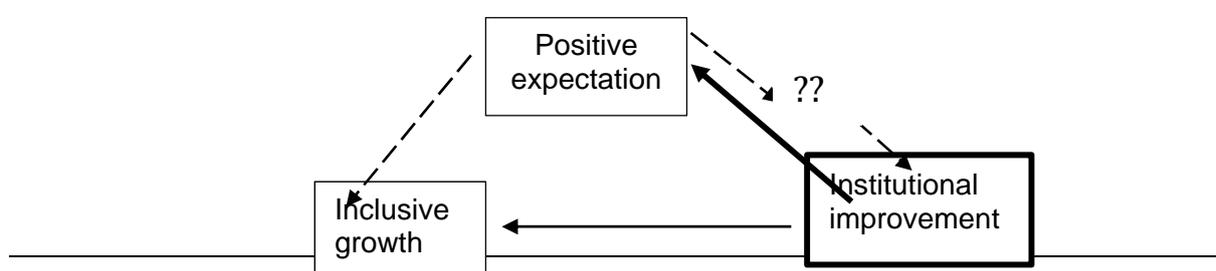
A third sub-circle links expectations and institutions. In this sub-circle, public institutions provide a ‘container’ for politics – a set of stability-enhancing rules for channelling collective action and citizen engagement. Citizens pressure to enhance the quality of the rules. Insofar as their pressure is successful, they gain increasing confidence that the rules of the game have the potential to work for them – ‘unstacking’ a deck which had hitherto been skewed to serve a privileged few. By nurturing compliance rather than confrontation, growing legitimacy lowers the transaction costs of co-operation, further strengthening institutions.

In the case of South Africa (illustrated in Figure 5), initial momentum came from the institutions-expectations virtuous circle, via gains in legitimacy and social stability in the

<sup>31</sup> This analysis is taken from Levy, 2014. As Levy details, the idea of a virtuous circle which links institutions and development is also used in Acemoglu and Robinson (2012). However, Acemoglu and Robinson take a very long-run view, which cannot usefully address the leads, lags and alternative pathways of change that are key to understanding South Africa's possible trajectories over a one-to-two decade time horizon.

wake of the new, post-1994 political institutions. But this sub-circle has only weakly been supported by the others. As this paper has detailed, though public services for the majority improved rapidly in the first decade post-apartheid, the pattern of development has remained highly dualistic. Economic growth (never very rapid, or very inclusive) also slowed in the wake of the global financial crisis, and (as per Table 3 earlier) it has been difficult to regain momentum. In consequence, there was a weak, mutually reinforcing growth-expectations virtuous circle. Instead, expectations have gradually soured – with pressures from disaffected groups in society winning South Africa the dubious reputation as ‘the service delivery protest capital of the world’ (Alexander, 2013). Arguably, these lower prospects of upward mobility risk undermining the broad support enjoyed by the ANC – and, more broadly, the legitimacy of the political and institutional order.<sup>32</sup>

**Figure 5: South Africa – virtuous development circles?**



With momentum slowing down, what comes next is profoundly uncertain. It remains possible (perhaps even likely) that constitutional democracy continues on a sustainable basis – with growth accelerating again, and with a combination of economic and political competition providing a continuing spur for better public sector performance, and progressively moving the economy in a more inclusive direction. A second possibility, outlined above, is the consolidation of a patronage-based equilibrium – one where public sector management is characterised by a mix of rule-bounded and discretionary decision-making, and where the discretionary allocation of rents plays a large (but not necessarily dominant) role in economic management. But a darker scenario also is possible. In this scenario, frustrated expectations put increasing pressure on institutions. The economy weakens. The combination of weaker institutions and fewer resources results in a reversal of the gains achieved in the provision of public services, further accelerating frustration, and setting in motion a downward spiral of decline. How can the risks of reversal be reduced?

### **5.3. Possible ways forward**

At the broadest level, South Africa already has in place a coherent framework for moving towards a more inclusive future, in the form of its National Development Plan (NDP). This lays out a substantive vision for building an inclusive economy and society by 2030. What is missing is the translation of this broad vision into an agenda for action.

The governing ANC brings both strengths and weaknesses to this task. Its strengths comprise its legacy of coherence as a programmatically oriented, disciplined political

<sup>32</sup> For a discussion of this risk in the context of Latin America, see Carter and Morrow (2007).

movement, the renewal of its electoral mandate in May 2014 (with a decisive, though somewhat reduced, majority), and the programmatic basis for that mandate provided by the NDP. Its weakness is in its declining capacity to hold together its 'big tent' in a way which facilitates coherent, developmentally oriented decision-making. This weakness is evident both in an ongoing atmosphere of crisis surrounding its top leadership, and in the emergence (in the wake of a chaotic dissolution of the ANC's youth movement) of a vocal populist opposition party, the Economic Freedom Fighters. Given these weaknesses, the risks are high that decision-making will continue to be responsive to pressures of patronage and corruption (perhaps even at an accelerating pace), avoiding any difficult trade-offs which might be needed to craft a pathway towards the long-run vision laid out in the NDP.

This final sub-section suggests some options for bridging the gap between the immediate challenges of governance and the long-run vision laid out in the NDP. The options are organised, loosely, into three sets of tasks: short-term tactics; a medium-term strategy for translating the NDP into action; and a bridge capable of connecting the short and medium term.

The immediate, short-term, tactical task is to limit the erosion of the relatively high-performing, impersonal institutions which are South Africa's crucial developmental asset. A struggle over institutional quality (including the quality of bureaucracy and of public service provision) can usefully be conceived of as a conflict between developmentally oriented and more predatory actors. Formal checks and balances institutions (e.g. ombudsmen; public protectors; naming and shaming through the media) comprise the natural first line of resistance to predation – and, indeed, actively play this role in contemporary South Africa. But the limitation of resisting predation through formal channels plus exhortation is precisely that predators are potentially impervious to these means – they use channels of political influence to put themselves out of reach of any formal legal frameworks of monitoring and enforcement to which participants might otherwise have had recourse.

Ultimately, as numerous comparative analyses have underscored,<sup>33</sup> what sustains impersonal, rule-bound institutions is civic engagement – including robust multi-stakeholder coalitions, that are capable of 'trumping' predatory threats, facilitating compliance with developmentally oriented rules of the game, and supporting (and pressing for) ongoing improvements in public service provision. The scope for multi-stakeholder engagement is far-reaching. In the South African context, it has ranged from the HIV Treatment Action Campaign, to the Right2Know coalition to scale back restrictive provisions of a proposed Protection of State Information law, to the Council for the Advancement of the South African Constitution (CASAC), to Equal Education and other non-governmental organisations committed to assuring high quality provision of public services.

The constitutionally mandated intergovernmental division of public responsibilities for the provision of public services comprises an important further arena for multi-stakeholder

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<sup>33</sup> For an influential early contribution which highlighted the civic underpinnings of governance arrangements, see Weingast (1993). For a comprehensive effort to apply the insight to a broad range of development problems, see Levy (2014: ch. 8-10).

engagement – though one which to this point has received relatively little attention from South African civil society. Decentralisation creates the scope for achieving developmental gains at sub-national levels, even during a period when leadership from central levels is limited. It is thus important that this space be protected – and that its developmental potential be leveraged more effectively. We return to this theme at the end of this paper.

Turning to the medium-term strategy for translating the NDP into an agenda for action, building on Figures 4 and 5, we would argue that South Africa's highest priority – higher even (given the political implications of failure) than the task of further reducing poverty in the bottom 40 percent of the distribution – is to accelerate economic growth, in a way that supports the sustainable creation of the missing middle range of jobs. This has both substantive ('what') and process ('how') dimensions.

The substantive tasks are twofold – a fiscal task and a policy task. The fiscal task is to mobilise and use additional resources in ways that encourage sustainable employment creation. The fiscal arithmetic of what needs to be done is straightforward: re-allocate up to, say, 5-10 percent of gross domestic expenditure from the top of the distribution towards the middle 40 percent – in ways that support sustainable job creation. The additional finance could be used to scale up the availability of public resources to invest in skills – both a sustained effort to turn around the deep weaknesses in the public education system (including perhaps an expansion of financing for tertiary education), and a parallel effort to revitalise the performance of the comprehensive system for further education and training which was put in place in the early years of the democratic era (but currently is performing very unevenly). It could also be used to incentivise work and job creation – via a comprehensive, continuing roll-out of the youth employment subsidy (for which implementation finally began in January 2014, after many rounds of controversy within the ANC alliance), and perhaps also an earned-income tax credit which can top up earnings of workers in the lower tiers of the 'middle 40' percent of the distribution.

The policy task (one which also involves public spending) comprises a variety of initiatives aimed at accelerating economic growth – and doing so in a way which supports job creation. Key aspects include:

- accelerating job creation and private investment – this will depend on providing a nurturing environment for job creation by both new and existing firms and, more broadly, strengthening confidence in the stability of the rules of the game over time;
- systematically reviewing the incentive regime for private investments to eliminate any continuing bias in favour of capital-intensive investments;
- accelerating public investment – a variety of ambitious infrastructural programmes are already at various stages of implementation, but realising the ambition will depend on sustaining (indeed strengthening) public sector capability.

Crucially, if inclusive growth is to be sustained, new job creation needs to be self-financing (beyond explicit subsidies along the lines identified above) – in the sense that the expansion of jobs is underpinned by sustained demand from domestic and global consumers willing

and able to pay for the goods and services provided. (As noted earlier, labour-intensive public works programmes play a useful role in alleviating poverty in the bottom half of the income distribution – but they cannot provide a sustainable platform for inclusive growth and elite formation. Similarly, a too-rapid expansion of white-collar public employment risks undermining both productivity growth, and broader macro-economic stability.)

There is also a crucial, process-oriented dimension to the medium-term strategic task of accelerating inclusive growth. Moving South Africa towards an accelerated and more labour-demanding growth path calls for far-reaching changes in behaviour on the part of both business and labour. In a recent book, Adam Habib lays these out as follows:

“A central dilemma...is how to enable economic competitiveness and the accumulation of work experience by new entrants to the labour market, without losing the hard-won gains of the labour movement.... Unions may have to compromise on a wage subsidy for new and young employees, and allow for special wage and employment provisions for certain economic sectors or geographic zones. Similarly, employers may have to commit to employment targets in these sectors and provide guarantees that they will not try to generalize these special provisions to the broader labour market....

“If the remuneration of both executives and employees were structured to contain corporate wage bills, and simultaneously stimulate productivity, shareholders would reap significant benefits.... Voluntary remuneration and bonus caps – which have been successfully implemented in several market economies, including Ireland and the Netherlands – may indeed have some merit in the South African case....” (Habib, 2013: 100; 136-137; 216-217).

As Habib argues, the commitments expected of each party would make it difficult to win support from their constituencies, unless they are part of a broader deal – a deal which ultimately brings all key players into a compact. So long as an underlying mismatch of expectations persists – a sense of grievance, of injustice and, conversely, of entitlement and resentment of change – then, considered on its own, each new initiative will be perceived in tactical terms, as part of a larger, ongoing struggle. To succeed, a social compact would need to have an impact beyond specific measures – it would need to transform social relations (both business–labour relations and, more broadly, relations across disparate segments of society) from conflict and mutual distrust to co-operation.

A robust social compact has long been the ‘holy grail’ of South Africa’s political economy. Tripartite co-operation between government, business and labour was pivotal in facilitating the transition to democracy. Since the dawn of South Africa’s democracy there have been repeated efforts to build on the early successes, and renew a robust ‘corporatist’ partnership. But success has been limited:

- The establishment of the National Economic Development and Labour Council (NEDLAC) in 1994 was an initially promising attempt to institutionalise a social compacting process. The Labour Market Commission of 1996 was intended to

consolidate the gains of NEDLAC, but its publication coincided with a stillborn National Growth and Development Plan, and a parallel Growth, Employment and Redistribution Programme, unilaterally implemented by government.

- A Jobs Summit in 1998 and a Growth and Employment Summit in 2003 were attempts to win back a common social partnership approach to growth and job creation, but they failed to re-establish trust between the key social partners.
- A 'New Growth Path' introduced 2009-2010 was an attempt by a union leader elevated to Cabinet to rebuild social partnerships, but the partnerships that were agreed upon had little impact on major issues of policy disagreement. Similarly, the NDP, which was carefully prepared by a broad group of experts appointed to the Presidency and which was officially adopted by the government and repeatedly endorsed by the ruling party, seems to have no significant impact on specific decisions on important policy issues.

The reasons for these repeated failures include different views of the future and differing emphases on short- and long-term issues, different assessments of the scope for radical reform, and the lack of a common and coherent vision of a society that is both an efficient generator of jobs and a promoter of increasing equality. An additional complicating factor has been the presence of COSATU (an interested stakeholder in any social pact) within the ANC ruling alliance. But perhaps the most fundamental reason has been a waning commitment to collaborative governance on the part of all three sets of actors – political, business and labour. Politically, a populist anti-established-business culture began emerging within the ANC and within government, at the same time as the leadership challenges described earlier hamstrung decision-making. Within the senior ranks of business and the trade unions, there is also (contrary to the pre-GEAR 1990s) an absence of obvious reformist leadership.

In the absence of committed leadership among the putative partners, the scope for social compacts is limited. As and when stronger leadership emerges, the agenda for such a compact could gain renewed momentum. But, in the short and medium term, it would be unrealistic to predicate a development strategy on such an outcome. What, then, during the current period of political, policy and institutional drift, can be done to address the third set of tasks identified earlier – bridging the gap between the difficult current reality, and a medium-term strategy of accelerating inclusive growth?

The task of finding a bridge between the current reality and the medium term is perhaps less daunting than it might appear. The situation in which South Africa finds itself – fragmented, polarised, with little prospect of clear leadership from the centre of power – is, in fact, not uncommon among developing countries, and indeed can be compatible with significant economic dynamism.<sup>34</sup> In such settings, the key to forward movement is to direct attention to achieving results within 'islands of effectiveness', where progress can be achieved via collective action among developmentally-oriented governmental, private sector and civil society stakeholders, even where the broader governance environment is difficult. As Levy (2014) details, in order for such an 'island' to thrive, three broad conditions need to be met:

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<sup>34</sup> Levy (2014) makes this case both theoretically and empirically.

- There need to be stakeholders with strong incentives to have the collective effort succeed. The stakeholders could be direct participants in the collective effort, or they could be 'outsiders'. Their incentives could be based on their own self-interest, insofar as they directly benefit from the fruit of the collective effort. They could also derive from the self-defined mission of an active civil society organisation.
- These stakeholders need to be sufficiently well connected politically with influential ruling factions to be able to fend off predatory pressures.
- Local leadership needs to come forward that is skillful in mobilising and coordinating the stakeholders in support of the collective endeavour – these leaders could come from within the collective endeavour, or could be external stakeholders who are skillful in mobilising to bring to bear pressure for good performance.

South Africa's political and administrative culture is one that has long been preoccupied with top-down approaches to policy-making and service provision; in consequence, the potential for 'islands' has not been systematically examined. Yet, when one begins to look, a variety of quite successful 'islands' becomes visible. Examples include: improvements in high school performance in the Free State; new investment commitments of upwards of 3,500 MW of new capacity in renewable electricity generation; public-private-community partnerships in forestry development in the Eastern Cape; quite successful scaling up of training in some (but certainly not all) of the Sectoral Training Authorities (SETAs); successful roll-out in many provinces (even in difficult settings, such as Limpopo) of labour-intensive public works programmes, which both provide employment and support the provision of local infrastructure and services; proactive local development strategies in the Western Cape; and the provision of basic infrastructure to low-income settlements in Ethekeweni.

To be sure, isolated examples of success are hardly sufficient to address South Africa's daunting challenges. But they suggest an approach which potentially can yield results at a more ambitious 'meso-level' level as well. Possible examples include:

- A major push for an employment-oriented special economic zone in the Eastern Cape, underpinned by negotiated agreement among stakeholders to do what it takes to create a large number (500,000, say) of new jobs – a 'meso-level' social pact of a kind that currently seems unachievable nationally.
- A focus on empowering and capacitating mid-level stakeholders – district-level offices, and school governing boards – as a way of improving performance in basic education by empowering local-level multi-stakeholder coalitions to push for school-level improvement.
- A collective agreement among government, business and labour to provide the social and physical infrastructure needed to build stable local communities, and phase out migrant labour (as has recently been agreed in the Northwest Province, in the wake of the labour crisis on platinum mines).

In time, perhaps, the political environment for delivering on peak-level agreements may become more favourable. But, in the meantime, development work can continue in those spaces where the requisite local conditions are in place; successes in some settings can

inspire coalition-building and experimentation in others – and the momentum of virtuous circles of hope and possibility can continue.

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## **ANNEX A: Earning levels along South Africa's distributional cliff**

As detailed in the body of this paper, a central – and robust – finding is that South Africa has a 'missing middle' of formal sector jobs in the 'middle-range' of the formal earnings distribution. While analysis of relative distributional patterns across countries and over time does not require precise measures of the absolute values which underlie these relativities, for policy purposes it would, of course, be helpful to get some sense of the absolute magnitudes involved. This annex explores this question further. In doing so, it comes up against some well known measurement problems in estimating precise absolute values of earnings of South Africa's workforce.<sup>35</sup>

**Annex Table A1: Decomposing South Africa's distributional changes (2010)**

	<b>Average earnings of largest income earner</b>	<b>Average earnings per household from all other income sources</b>	<b>Average size of household</b>	<b>Average annual per capita income</b>
1 <sup>st</sup> ventile	265,089	81,555	2.31	150,290
2 <sup>nd</sup> ventile	171,821	64,609	2.79	84,644
3 <sup>rd</sup> ventile	122,045	41,281	2.86	57,039
4 <sup>th</sup> ventile	90,110	31,188	2.88	42,051
5 <sup>th</sup> ventile	65,880	20,185	3.03	28,404
6 <sup>th</sup> ventile	56,054	18,517	3.13	23,824
7 <sup>th</sup> ventile	41,220	14,921	3.26	17,237
8 <sup>th</sup> ventile	34,695	11,330	3.41	13,484
9 <sup>th</sup> ventile	30,907	12,237	3.75	11,491
10 <sup>th</sup> ventile	30,379	12,761	3.91	11,047
11 <sup>th</sup> ventile	27,537	10,781	4.02	9,529
12 <sup>th</sup> ventile	23,444	10,696	4.35	7,842
13 <sup>th</sup> ventile	22,187	10,889	4.55	7,267
14 <sup>th</sup> ventile	18,751	9,233	4.71	5,939
15 <sup>th</sup> ventile	20,294	12,548	5.22	6,288
16 <sup>th</sup> ventile	20,137	10,801	5.40	5,732
17 <sup>th</sup> ventile	15,838	10,025	5.76	4,496
18 <sup>th</sup> ventile	15,185	9,853	5.96	4,201
19 <sup>th</sup> ventile	14,647	11,212	6.35	4,071
20 <sup>th</sup> ventile	11,070	8,500	6.41	3,051

Source: Source: Statistics South Africa, *Income and Expenditure of Households, 2010*

Note: The ventiles are constructed using household expenditure data from the 2010 survey. Inconsistencies in the reported patterns of income and expenditure can result in anomalies (e.g. that calculated per capita income is higher in the 15th than the 14th ventile).

<sup>35</sup> An important part of the problem appears to lie in the differences between gross and take-home earnings – both tax payments and benefits paid for by off-the-top deductions from gross pay. For one useful recent summary of the difficulties, see Seekings (2014).

Annex Table A1 uses earnings measures from the 2010 Income and Expenditure Survey to provide disaggregated measures of the component parts of average per capita income for all 20 ventiles, distinguishing between earnings of the largest income earner and earnings from all other sources. Note that 'earnings' is a more encompassing category than 'wages'. As data even more disaggregated than that in Annex Table A1 show, for the top two ventiles, 30-40 percent of earnings of the largest income earner come from returns on capital assets. And as one moves down to lower ventiles, increasingly large shares of income are from social grants. However, for the range of the distribution in which we are interested, the differences between 'wages' and 'earnings' are smaller. The discussion which follows thus uses 'earnings' as a proxy for wages.

**Annex Table A2: Average monthly earnings for the largest income earner per household (Rands)**

	<b>South Africa (2010)</b>	<b>Mexico (constructed)</b>	<b>Turkey (constructed)</b>
3 <sup>rd</sup> ventile	10,170	9,150	8,640
4 <sup>th</sup> ventile	<b>7,510</b>	<b>7,200</b>	<b>7,220</b>
5 <sup>th</sup> ventile	<b>5,490</b>	<b>6,100</b>	<b>6,300</b>
6 <sup>th</sup> ventile	<b>4,670</b>	<b>5,190</b>	<b>5,590</b>
	<b>[4,000]</b>		
7 <sup>th</sup> ventile	3,440	<b>4,680</b>	<b>4,980</b>
8 <sup>th</sup> ventile	2,890	<b>4,170</b>	<b>4,470</b>
9 <sup>th</sup> ventile	2,580	3,760	<b>4,170</b>
10 <sup>th</sup> ventile	2,530	3,355	3,760

Annex Table A2 uses a 'constructed' contrast between South Africa, Mexico and Turkey as a way of trying to locate South Africa's missing 'middle range' of earnings and of jobs. The first column repeats the estimates in Annex Table A1 of average earnings of a South African household's largest income earner, by ventile (converted into a monthly earnings figure). Columns 2 and 3 present comparable, notional estimates for Mexico (a country with an intermediate distributional cliff), and Turkey (the country with the flattest cliff), based on three simplifying assumptions that:<sup>36</sup>

- Mexico and Turkey's distributions by ventile are as reported in Table 12;
- average per capita incomes are identical across the three countries (with South Africa's per capita income used as the 'anchor'); and
- within each ventile the ratios of earnings of the largest earner to household earnings from all other sources are the same in the other countries as in South Africa.

Note that, insofar as the last set of ratios is in fact higher for South Africa, Annex Table A2 overstates average monthly earnings for Mexico and Turkey (with the paragraphs which

<sup>36</sup> Using these assumptions, the estimates for Mexico and Turkey are calculated as follows: (i) The 3rd ventile estimates take the South African earnings measure as a starting point, and weight it by the ratio of the Mexican (or Turkish) 3rd ventile distributional share (from Table 9) to South Africa's 3rd ventile distributional share for 2010; (ii) The 4th through 10th ventiles are calculated as ratios of the 3rd ventile value, using the distributional weights from Tables 9 and 12.

follow similarly overstating the relevant 'middle-range-of earnings' on which to focus in expanding formal employment in South Africa).

Annex Table A2 underscores just how pronounced, relative to the other countries, is the decline in average earnings of the largest income earner in a South African household as one moves from the 3rd to the 7th ventile. Earnings within the bolded ventiles – the missing middle-range of earnings – comprise about 12.5 percent of the jobs of primary household earners in South Africa, about 22.5 percent in Mexico, and more than 25 percent in Turkey.

Based on the data and assumptions used to construct Table A2, the absolute magnitude of the earnings range of the missing jobs is R4,000-7,500 per month in 2010 Rands (approximately R5,000-R9,400 in current 2014 Rands).<sup>37</sup> Viewed against the backdrop of wage demands by organised labour, this is a strikingly low number – the demand motivating 2014 strikes in the platinum mining sector was for R12,500 per month for unskilled workers – but it is almost surely something of an underestimate, though the magnitude of the underestimation is very uncertain. Some analysts suggest that the underestimate is in the 25-40 percent range.<sup>38</sup> Other analysts suggest that it is much larger – they note that summing up earnings reported from surveys yields a per capita income sharply below the amount calculated using national accounts statistics. (See the note to Table 11 for an explicit comparison of the two measures.) Which is a more accurate estimate of the labour market reality is, of course, of no small import for government policy and for decision-making on the part of business and labour – but this is an empirical question the answer to which goes beyond the scope of the present effort.

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<sup>37</sup> About \$5-900 per month at prevailing 2014 exchange rates.

<sup>38</sup> Seekings (2014) suggests this range, based on a careful review of the empirical literature.

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